R9050-3
1/11/89

TAX FOUNDATION'S VOL. 32, NO. 8 NOVEMBER/DECEMBER 1988

TAX·FEATURES

James Riordan of Mobil Corporation Elected as Chairman of Tax Foundation's Board

Archer Urges Bipartisanship and Aggressive Action to Confront Deficit

"We will have an opportunity . . . perhaps only a brief one early in the year," Congressman Bill Archer told Tax Foundation's 51st annual dinner in New York November 30, "to take control of the situation and confront the problem of the federal deficit head on." At the dinner, Representative Archer received the Tax Foundation's Distinguished Public Service Award for 1988 from incoming Board Chairman James Q. Riordan of Mobil Corporation.

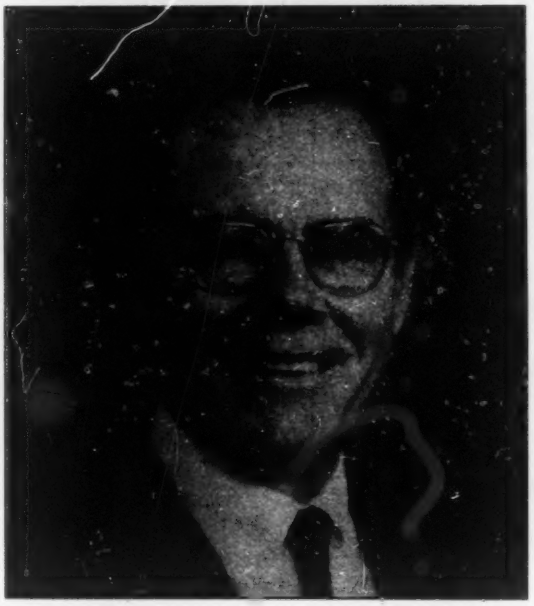
The penalty for failing to deal early with the deficit, the Ranking Republican on the Ways and Means Committee warned, is that "we'll likely face the consequences of having fiscal events control us . . . rather than the other way around."

> ***"We will have an opportunity . . . perhaps only a brief one early in the year, to take control of the situation and confront the deficit head on."***

To avoid what he called "a collision course with fiscal reality," Archer urged the Congress and the Administration to "set aside the rhetoric and demagoguery of election-year politics—and join together in dealing with the reality of a problem which cries out for a bipartisan solution." The Texas Congressman cited a number of factors that he predicted would "generate enormous budgetary pressure":

- "The removal of the Social Security trust funds (and their deficit-masking reserves) from the unified federal budget."
- "The unfunded liability of FSLIC over the next several years."
- "The Department of Energy's cleanup and

(Continued on page 2)



James Q. Riordan

James Q. Riordan, Director, Vice Chairman, and Chief Financial Officer of Mobil Corporation, was named Chairman of the Tax Foundation's Board of Trustees at the Foundation's November 30 Board meeting in New York on November 30. In announcing his election, out-going Chairman Hans W. Wanders of The Wachovia Corporation described Riordan as "a man superbly prepared for the job, with service in both the Executive and Legislative Branches of the Federal Government, the law and the tax and financial sides of a major corporation."

Riordan joined Mobil Oil in 1957, after a varied career that included service on the staff of the House Ways and Means Committee, the Tax Division of the Justice Department, the office of the U.S. Attorney for the Southern District of New York, and private practice with several New York law firms. He became a trustee and member of the executive committee of the Tax Foundation in 1984.

"Having workerd with him closely for the last four years," Wanders told the business executives and press attending the Foundation's annual dinner, "I can assure you that the Foundation is fortunate to have an individual of his competence and dedication to lead it."

THIS ISSUE:

PAGE 1:
Riordan Named Chairman
Archer Speech
PAGE 3:
"Budget Watch"
PAGE 5:
"Front Burner"
Base Closing
INSERT:
Annual Subject Index

(ARCHER, *from page 1*)
modernization of nuclear weapons production facilities."

• "The Department of Defense's hazardous waste cleanup program."

"Our resolve is going to be sorely tested," he cautioned.

Archer went on to describe the confrontation built in to President-elect Bush's no tax pledge and the determination of House Speaker Jim Wright that he will "insist on tax increases." Furthermore, Archer noted, the Democratic leadership will insist that the President "be the first to make the tough choices." He added, "The resolution of these diametrically opposed viewpoints—along with the political implications involved—is obviously the crux of the issue we face in 1989."

Archer described himself as equally opposed to tax increases and as sharing the incoming President's conviction that "federal spending remains the villain in the federal deficit story." He also indicated, however, that"given the majorities which now control the House and Senate . . . I don't think we can win that battle in 1989," short of allowing "the Gramm-Rudman automatic sequestration trigger to be pulled." He added that he did not believe Congress would allow this to happen, since they would not be willing "to pay the price of across-the-board cuts in non-entitlement programs."

"Federal spending remains the villain in the Federal deficit story."

There is danger even if the government reaches the point where sequestration or a waiver of sequestration is seriously considered, Archer asserted, cautioning, at that point, "the whole process will become driven by the politics of the situation . . . and any hope of bipartisanship will go out the window." Should this occur, he forecast "a return to the bitter confrontational atmosphere of 1987."

Archer called that a "giant step backward from the healthy spirit of bipartisanship which Dan Rostenkowski and I have tried—successfully—to nurture in the Ways and Means Committee this year," a step neither he nor Chairman Rostenkowski wanted to see taken.

"One of the most unfortunate legacies of tax reform is some implied understanding that provisions which were linked to one another . . . for the purpose of winning support for the overall package . . . somehow should remain linked for all time."

The Democratic majority is "likely" to send the President a bill containing revenue increases, Archer predicted, although he indicated that he foresaw no new form of taxation. He described the question as "not so much whether there will be such a bill, but whether the Administration—and Republicans in Congress—will have a hand in shaping one which the President might sign." He warned, "The stage is clearly set for such a bill in 1989," noting a number of factors pointing in that direction.

Archer urged that "the reality of the situation demands early bipartisan action"and called for a budget summit "during the first weeks of the new Administration."

He asked for "serious, substantive discussions about a multi-year program of deficit reduction."

Regarding prospects for tax increases during the coming year, Archer pointed out, "If we're going to be dealing with additional revenues as part of the agreement . . . and reality tells me that in spite of my own strong preferences the majority will likely insist on new revenues . . . we should do so on the basis of tax policy . . . not tax politics." He added that if the minority party does not become part of the process early on, the majority party will not take the time "to step back from the political rhetoric of recent campaigns . . . and look at the overall policy benefits of measures such as a capital gains tax differential and the indexation of the cost basis of capital gains." Other policy issues that may be overlooked include foreign source income provisions, simplicity, international competitiveness, private pension plans, the corporate minimum tax and passive loss rules.

"One of the most unfortunate legacies of tax reform is some implied understanding that provisions which were linked to one another . . . at that time . . . for the purpose of winning support for the overall package . . . somehow should remain linked for all time," Archer observed. Instead, he called on Congress to "reopen" major areas of the 1986 Tax Reform Act for policy review.

"I'm not suggesting that 1989 should be the year that the entire tax code is reviewed and rewritten again," he explained, adding "I do think, however, that it's time to being moving ahead with Tax Reform. . . . That's a process we can begin in 1989."

The Texas Congressman concluded his remarks with a call for cooperation toward that objective. "Right now is the time and place for statesmanship—not partisanship . . . policy—not politics . . . cooperation—not confrontation . . . answers—not excuses," he told the corporate executives and press attending the dinner.

Tax Features

Tax Features (ISSN 0883-1335) is published by the Tax Foundation. Original material is not copyrighted and may be reproduced. Please credit Tax Foundation.

Chairman of the Board . . . . . Hans W. Wanders
President . . . . . Robert C. Brown
Senior Vice President . . . . Edward A. Sprague
Editor . . . . . William J. Wilson
Contributing Editor . . . . . Allen Schick
Contributing Economist . . . . Paul G. Merski
Consulting Economist . . . . . Elsie M. Watters
Publications Specialist . . . . . William Ahern

Tax Foundation
One Thomas Circle, N.W., Suite 500
Washington, D.C. 20005
(202) 822-9050

Budget Watch By Allen Schick

Reagan's Budget Legacy and Bush's Budget Quandary

George Bush will inherit a budget and an economy shaped by his predecessor's policies and actions. When he takes office in January, the new president will have to decide whether to continue on the path charted by Ronald Reagan during the past eight years. His predicament will not be an enviable one: doing nothing might trigger deep percentage cuts in national defense and in numerous social programs; raising taxes or selectively curtailing programs might be an unpopular beginning for a new President. If the recent election campaign is a guide, Bush will oppose tax increases, seek to restrict spending growth to the rate of inflation, avoid big shifts in fiscal policy, and hope for a gradual reduction in the budget deficit. But staying on course will depend on a cooperative economy as well as on a cooperative Congress. A number of things can quickly go awry and compel the new President to deviate from inherited policies or campaign pledges. Even if the early months of his presidency are quiet, Mr. Bush might come up against the deficit targets set by the Gramm-Rudman-Hollings process.

When he takes office in January, [Bush] will have to decide whether to continue on the path charted by Ronald Reagan . . . His predicament will not be an enviable one . . .

The Pesky Budget Deficit

Deficits have been standard operating procedure in Washington for some time. The last balanced budget occurred in 1969; only 10 of the past 60 budgets have paid their own way. But there is a startling difference in magnitude between Reagan's deficits and those incurred in earlier periods. Before Reagan, most deficits were quite small; Reagan's have been huge. In the 1970s, the biggest deficit was $74 billion; in the 1980s, the smallest has been $74 billion. Budget deficits averaged less than 1 percent of GNP in the 1960s, more than 2 percent in the 1970s, and almost 4 percent of GNP thus far in the 1980s. By the time the books are closed on the Reagan era, the cumulative deficit will have been almost one and a half trillion dollars and the national debt (which grows faster than the deficit) will have tripled from $900 billion at the start of the decade to more than $2.8 trillion.

The Economy: Is Growth Enough?

President Bush will not be able to count on the economy to solve his deficit problem. In the past, deficits abated when the economy expanded, as additional funds flowed into the treasury. One of the truly startling characteristics of recent deficits is that they have persisted during the longest peacetime expansion in American history. The United States has just completed six consecutive years of expansion, but the annual deficit is stuck above the $100 billion mark. The long expansion and the lowest unemployment rate since the early 1970s are justifiably among President Reagan's proudest achievements. Reagan's policies have been a major factor in this favorable economic performance. By avoiding the policy lurches which characterized the 1970s, Reagan has provided markets and entrepreneurs with clear and stable signals. But while growth has been protracted, it has not been as robust as in past cycles. Real output increased 38 percent during the 1970s and (with only one year to go in this decade) less than 25 percent in the 1980s. Thus, even if George Bush avoids an early recession, economic growth will have been significantly weaker than in previous decades. It might be difficult to squeeze additional growth out of the economy without risking a resurgence of inflation. Whatever its virtues, moderate growth assures continuing deficits under current revenue and spending policies. Even if they were sustained for an extended period of time, real gains of three percent or less a year will not supply a sufficient increment for the government to grow out of the budget deficit. CBO has projected a baseline deficit in excess of $120 billion for fiscal 1993—the year that the Gramm-Rudman-Hollings law promises a balanced budget. Two recent bits of news point to the intractability of the deficit under existing policy. One was the report that the fiscal 1988 deficit exceeded that for the previous year; the other was that OMB has added more than $20 billion to the estimated 1990 deficit.

President Bush will not be able to count on the economy to solve his deficit problem. . . . One of the truly startling characteristics of recent deficits is that they have persisted during . . . six consecutive years of expansion. . . stuck above the $100 billion mark.

These news items might be harbingers of still more unfavorable developments in the years ahead. Leaving aside the growing balances in the social security trust funds, the deficit in the general accounts is expected to worsen during George Bush's term as President. Without these balances, the fiscal 1993 baseline deficit would be $220 billion, some $100 billion higher than CBO has projected for the unified budget. If the social security balances are used to finance the deficit, the United States will continue to have inadequate savings and it will con-

(Continued on page 4)

(BUDGET WATCH, *from page 3*)
tinue to look abroad for large infusions of capital. Unfortunately, much of the borrowed money has gone to prop up consumption. Without increased saving and investment, the massive run-up in debt will have to be serviced by an economy whose long-term potential has been diminished by weak productivity gains. Not only will we have a bigger debt burden, but we will have a smaller (than possible) economic base from which to pay our obligations. If growth doesn't suffice, George Bush will have only two ways of dealing with the deficit: more taxes or less spending. The first option would break with Reagan's policies and with Bush's campaign pledges; the second would run afoul of pressure in Congress and elsewhere to maintain current or higher levels of expenditure.

Reagan's Tax Legacy: More Earmarked, Fewer General Taxes

George Bush will confront a markedly different tax situation than the one which Ronald Reagan faced eight years ago. Income taxation has been revolutionized by Ronald Reagan. The top tax rate on individual income has been reduced from as much as 70 percent to only 33 percent; the top corporate rate has been lowered from 46 percent to 34 percent; numerous preferences have been ended or narrowed; and individual tax rates have been indexed to changes in consumer prices. As a result of these and other policy changes, individual income taxes have dropped from 9.6 percent of GNP in 1981 to an estimated 8.2 percent in 1989. Had these taxes remained constant relative to GNP, Americans would now be paying $60 billion more in income taxes each year.

If the social security balances are used to finance the deficit, the United States will continue to have inadequate savings and it will continue to look abroad for large infusions of capital.

The decline in income taxes has been partly offset by a rise in social security taxes. Social insurance taxes have climbed from 6.1 percent of GNP in 1981 to an estimated 7.1 percent in 1989. These taxes now produce 36 percent of total federal revenue, up from 31 percent in Reagan's first year.

Total federal revenue has receded from the historically high level (20 percent of GNP) reached in 1981. But at 19.3 percent of GNP, it is still a full percentage point above the average for the 1970s. This comparison with past tax burdens is the basis of President Reagan's claim that the deficit is not due to undertaxation. But while it is true that total revenue remains above the long-term trend, the changing composition of the revenue has led to a situation where the government collects ample funds for earmarked purposes but is unable to cover the costs of programs which lack their own revenue source. General revenues, which pay for national defense, the ongoing operating costs of government agencies, and most discretionary domestic programs, are now a smaller percentage of GNP than at any time since World War II. General revenue is less than 12 percent of GNP; it was almost 15 percent of GNP in 1960 before any of the Great Society programs were established. The inadequacy of general revenue is the main cause of today's budget deficit. The trend toward earmarked revenue and away from general taxes might pick up steam during the Bush presidency. As a candidate, Bush indicated a strong preference for earmarked taxes, such as the additional medicare premium levied this year to pay for new catastrophic illness coverage. Apparently, Mr. Bush does not regard these earmarked payments as taxes; hence, they would not be precluded by his "read my lips" opposition to tax increases. There appears to be strong political support for the lower marginal tax rates enacted in 1986. These rates may be the most untouchable feature of the Federal tax structure. Politicians will have to look elsewhere it they want additional revenue. It also will be difficult to raise significant amounts of revenue by closing loopholes in the tax laws. Most of the corporate tax preferences have been eliminated; most of the individual tax preferences enjoy widespread political support. In the aftermath of last year's market crash, the President and Congress negotiated for more than a month before coming up with $27 billion of revenue enhancements (over a 2-year period). In calmer circumstances, even this relatively small amount of revenue might be beyond reach.

Reagan's Spending Priorities

Ronald Reagan has had his share of budget ups and downs. No previous president was so successful in quickly molding the budget to fit his policies. At the dawn of his presidency, Reagan skillfully pressured Congress to revamp national priorities by cutting domestic programs and building up defense resources. Barely half a year after he took office, Congress had enacted far-reaching cutbacks in federal spending and a steep drop in tax rates. Since 1981, however, Reagan and Congress have been locked in a protracted budgetary war, with neither side able to dislodge the other from its basic positions. The table on the next page indicates that Reagan has had modest success in altering budget priorities, but there are both similarities and differences in the last pre-Reagan budget and Reagan's final budget. Three categories—national defense, interest charges, and mandatory payments—account for about 85 percent of federal spending. All other programs compete for the remainder.

Apparently, Mr. Bush does not regard these earmarked payments as taxes; hence, they would not be precluded by his "read my lips" opposition to tax increases.

(Continued on page 5)

Budget Deficit

Address budget and deficit issues, Shadow Committee urges candidates. Tax Features Feb./Mar. 1988 p. 1.

Lessons from the budget summit, by Allen Schick. Tables. Tax Features Jan. 1988, p. 3.

Reagan's budget legacy and Bush's budget quandary, by Allen Schick. Table: Budget and GNP shares. Tax Features Nov./Dec., p. 3.

Shadow Budget Committee urges deficit reduction upon National Economic Commission. Tax Features July/Aug. 1988, p. 1.

Budget Procedure

Shadow Committee urges new budgetary procedure during transition. Tax Features Oct. 1988, p. 1.

Corporations – Taxation

Corporate tax burdens, by Edward A. Sprague. Historical tables: receipts; profits; legislation; federal/state/local income and payroll taxes. Federal Tax Policy Memo Feb./Mar. 1988. 2 pages.

Corporations, Multinational

New study hits U.S. taxation of multinationals. Tax Features Feb./Mar. 1988, p. 2.

Defense Budget

The defense roller coaster, by Allen Schick. Historical table. Tax Features Apr./May 1988, p. 3.

Deposit Insurance, Federal

Time bomb for taxpayers: Federal credit losses, by John Hanly Adams. Federal Tax Policy Memo, Oct. 1988. 2 pages.

Expenditures, Federal

The disappearing impoundment power, by Allen Schick. Table: Rescissions and deferrals, 1975 - 1988. Tax Features Oct. 1988, p. 3.

Making elderly Americans dependent on government assistance, by Allen Schick. Table: Federal outlays. Tax Features Feb./Mar. 1988, p. 3.

Moderate income American family will pay total Federal taxes of $7,943 in fiscal 1988. Table: Federal expenditures by function and workers' share. Tax Features Apr./May 1988, p. 4.

Will there be a new boom in Federal spending? by Allen Schick. Tax Features Sept. 1988, p. 3.

Expenditures, Government

Government and your tax dollars: the spending side. Table: How Federal, state and local governments spend each dollar of public funds, 1960 - 1986. Tax Features July/Aug. 1988, p. 7.

Grants-in-aid

Federal grants drop 4.5%; FL, TX pay highest aid premiums. Table: Grants and tax burden for grants by state, FY 1987. Tax Features June 1988, p. 2.

Income

Typical two-earner family increased purchasing power since 1980. Table: Median income before and after direct Federal taxes and inflation, 1980 - 1988. Tax Features June 1988, p. 1.

Property Taxes

1986 property tax growth outpaces other taxes. Table: Collections by state, per capita and per $1,000 personal income, FY 1976 and 1986. Tax Features Feb./Mar. 1988, p. 1.

Revenue

Government and your tax dollars: the revenue side. Table: How Federal, state, and local governments raise each dollar of public funds, 1960 - 1986. Tax Features July/Aug. 1988, p. 3.

Revenue, Federal

The deficit that won't go away, by Allen Schick. Historical tables: General fund and trust fund balances, and total deficit and debt; general fund receipts. Tax Features July/Aug. 1988, p. 3.

Hidden taxes and user fees: the plague spreads, by John Hanly Adams. Federal Tax Policy Memo Sept. 1988. 2 pages.

Revenue Act of 1987

Tax package adopted; process sags again, by Edward A. Sprague. Table: Vanished corporate tax cut of 1981. Federal Tax Policy Memo Jan. 1988. 2 pages.

Social Security

Social Security tax: how regressive? Graphics and tables: Effective tax rates; Monthly benefits; Earnings, benefits, and replacements rates. Federal Tax Policy Memo July/Aug. 1988. 2 pages.

The future of social security financing, by Edward A. Sprague. Tables: OASDI and HI ncome and outgo by alternative assumptions 1988 - 2060; Age structure of transfers under OASDI. Federal Tax Policy Memo June 1988. 8 pages.

Social Welfare

Social welfare outlays dominate government expenditures. Table: Federal, state and local expenditures by source of funds and type, FY 1960 - 1985. Tax Features Sept. 1988, p. 5.

Tax Burden, Federal

FY '88 tax burden up $55 billion; increase falls on corporations. Table: Tax burden by state. Tax Features Feb./Mar. 1988, p. 2.

Top 50 percent of earners pay 93.8 percent of Federal individual in-

(Continued on back)

come tax burden; top ten percent pays over half. Graphic. Table: High and low income taxpayers: 1979 and 1986. Tax Features June 1988, p. 1.

Tax Burden - U.S.

Tax Freedom Day 1988 is May 5; two days later than 1987. Graphics. Tax Features Apr./May 1988, p. 1.

Tax index reaches record level as 1st quarter 1988 taxes rise $110.9 billion. Table: Total, Federal, state and local indices 1970 - 1988. Tax Features Oct. 1988, p. 2.

Workers lose two more minutes of a day's pay to tax bite. Historical table, graphic. Tax Features Apr./May 1988, p. 1.

Tax Evasion

Persistent tax gap due mostly to individual underreporting. Table: Income tax gap by source, tax year 1987. Tax Features July/Aug. 1988, p. 1.

Tax Expenditures

Tax expenditures: myths and realities, by Allen Schick. Tables. Tax Features June 1988, p. 3.

Tax Legislation

U.S. endures two decades of accelerating tax legislation; wobbling in Federal policy. Table: revenue impact on corporations and individuals, total as percent of GNP, 1964 - 1990. Tax Features Jan. 1988, p. 1.

Taxation - OECD Countries

Tax structures vary greatly within OECD. Table: Percentage distribution of revenues in selected countries by source, FY 1986. Tax Features Oct. 1988, p. 5.

Taxation, Federal

"Soak the Rich" by taxing the highest earners 100 percent . . . and run the Federal government for 12 days! Table. Tax Features Sept. 1988, p. 1.

Taxation, State

State tax and fiscal prospects, 1988, by Elsie M. Watters. Special Report Apr./May 1988. 4 pages.

Sales taxes rake in revenue for the states. Tables: revenues by type of tax state tax rates. Tax Features Apr./May 1988, p. 6.

(BUDGET WATCH, *from page 4)*

National defense. Defense has been the most cyclical part of the budget. After rising sharply in the first half of the 1980s, the new resources provided the Pentagon have levelled off in the second half. This pattern closely conforms to shifts in public opinion. Most Americans favored the defense buildup at the start of the decade; most now think that defense spending should remain the same or be decreased. Although the Defense Department has $250 billion in carry-over funds which have facilitated its adjustment to more austere circumstances, it will not be able to acquire all the weapons scheduled in its 5-year plan. Nor will it be able to man and operate all the forces it already possesses unless the defense budget is permitted to grow in real terms. The 1989 Reagan budget was a harbinger of what might be in store for a Bush Administration. Despite his strong support for defense, Reagan proposed the deactivation of air wings, early retirement of ships, and other force reductions. For the most part, however, the last Reagan budget relied on deferments and stretch-outs to avoid a basic review of mission and force levels. It is doubtful that these expediencies will suffice if the defense budget is held to zero real growth.

Mandatory entitlements. Most of these are payments to the retired, poor, disabled, unemployed, or other persons entitled to financial assistance. These payments are mandated by law; in most cases, cost of living increases are also mandated.

Ronald Reagan has had little success in curbing the growth of these payments. They have the same share of GNP today as in 1980, and they now account for almost half of total outlays. There appears to be widespread political support for protecting means-tested entitlements (for low-income persons) against cutback and political opposition to cutting middle income transfers. Social security benefits are treated as untouchable by Democratic and Republican politicians alike. Medicare has been nicked, but its costs race ahead of GNP and over-

(Continued on page 6)

THE FRONT BURNER

By Robert C. Brown
President, Tax Foundation

"Mandated Benefits"

Official Washington is cagey. Bar one road to increasing spending, and the White House and the Congress will quickly find another. The child of the 80s, when it comes to backdoor spending, is Mandated Benefits.

Under this rubric, Uncle Sam determines a benefit the citizens are deemed to need. The private sector is then required to provide and pay for this worthy service.

Caught between the rock of Gramm-Rudman deficit targets and the hard place of demands for new programs or increased benefit levels in existing ones, Congress made its first major move in this direction under COBRA, the Consolidated Omnibus Budget Reconciliation Act of 1985, which mandated continuing health care for employees who were laid off and their families. The 101st Congress, under the same pressures, will probably try to mandate benefits for long-term health insurance and parental leave, among others.

What's so bad about that? Improving and expanding benefits is in many cases a worthy goal. But letting Uncle Sam decide what those benefits shall be, who shall furnish them, and at what level, may not be the most desirable way of addressing the social agenda.

First off, what has happened to the due process clause of the U.S. Constitution? Does government have the right to preempt millions of dollars of corporate revenues and specify how these shall be spent without giving corporate officers or shareholders any say?

Next, while we have yet to assess the impact of mandating benefits on the collective bargaining process, it is only logical to reason that the more items that are mandated, the fewer things that are on the table come contract time.

An additional consideration is that when government mandates benefits, finessing the cost onto U.S. businesses, the pain of paying for the program is detached from the pleasure of receiving the benefit. This is always bad policy. The net drag on the economy, however real, may be imperceptible, but the death of a thousand cuts is just as lethal as beheading — it only takes longer.

Finally, as someone said in a different context, "The generals are always preparing to fight the last war." Big government is usually behind the curve, often out of touch with reality. A number of years ago, a Federal agency prescribed how New York City's buses ought to be built to reduce polution and increase safety. The only problem was that the buses kept breaking down, and New York City had to acquire older buses from Washington, D.C., to keep its surface transportation system running.

Do we really want the White House and Congress telling all Americans exactly what benefits they need, at what level, for what cost, and then embedding these programs in the corporate benefit system? I suspect not. I suspect that doing so would simply give us a bus that looked good on paper, but that ended up either taking us to the wrong destination or nowhere at all.

Base Closing Commission

The President has signed a law empowering a Carlucci-chosen commission to produce a list of bases suitable for closing. The commission's schedule:

12/31/88 Commission report submitted to defense secretary.

1/16/89 Defense secretary submits list to Congress, if he chooses.

3/1/89 Start of 45-day window during which Congress can veto the base closing list – only by majority of both houses.

1/1/90 Earliest date first base can be closed.

(BUDGET WATCH, *from page 5*)

all budget trends.

George Bush can expect enormous pressure in this sector of the budget. There are strong demands for federal assistance in financing nursing and home care for the elderly. As the number of elderly Americans rises, so too does their draw on the federal budget.

Net interest. This is the truly uncontrollable portion of the budget, for it represents outstanding commitments to bondholders. Interest payments have soared along with the accumulation of public debt. In 1980, less than 9 percent of outlays were diverted to interest charges; today more than 14 percent is paid out in interest. With the buildup in debt, the budget has become increasingly sensitive to fluctuations in interest rates. The recent uptrend in these rates has added billions of dollars to the fiscal 1989 deficit.

Nondefense discretionary spending. This "all other" category covers hundreds of federal programs, the operating costs of federal agencies, and many grants to state and local governments. This is the area in which the Reagan budget revolution has been most successful. Discretionary domestic spending has been crowded out by other demands on the budget, and its share of national output and of total outlays is substantially less than at the start of the decade.

Much as he may want to do so, George Bush will not have much opportunity to sharpen his budget knife here. The big cuts have already been made. While additional savings may be justified, it will be hard to marshal support for them. In fact, Candidate Bush identified a number of problem areas—education, drug control, day care and environmental protection, for example—where additional resources might be allocated.

Budget and GNP Shares
(In percent)

	Budget Shares*			GNP Shares*		
	1980	1985	1989 est.	1980	1985	1989 est.
National defense	22.7	26.7	26.6	5.0	6.4	5.9
Mandatory entitlements	47.0	46.3	47.5	10.4	11.1	10.5
Net interest	8.9	13.6	14.5	2.0	3.3	3.2
Discretionary domestic	26.6	18.6	16.9	5.9	4.5	3.7
Total outlays	—	—	—	22.1	24.0	22.1

Source: Congressional Budget Office
*Because offsetting receipts are excluded, the budget and GNP shares add up to more than 100 percent.

The Budget Honeymoon

George Bush will face tough choices almost immediately after taking office. By then, the 2-year budget agreement will be drawing to a close and the gap between the fiscal 1990 GRH deficit target and budget realities will become more evident. Ronald Reagan's departing budget—to be issued about 10 days before inauguration—will undoubtedly paper over the gap by proposing severe cuts in both discretionary and mandatory programs. One of Bush's early decisions will be whether he should stick with Reagan's budget or develop his own proposals. His predicament will not be an enviable one: doing nothing might trigger deep percentage cuts in national defense and in numerous social programs; raising taxes or selectively curtailing programs might be an unpopular beginning for a new President. Congress will have a big say in budget policy. The overwhelming odds are that 1989 will not be a replay of 1981, that Bush will have difficulty imposing severe domestic cutbacks on a Democratic Congress that gained strength in the recent election. Bush can decide to confront Congress on budget policies and priorities, refusing to give ground until the government is at the brink of stalemate. Or he can seek a less confrontational honeymoon, seeking a negotiated agreement with Congress. The most relevant precedent for Bush might be what Reagan did near the end of his presidency, not what happened at the start.

Tax Foundation
One Thomas Circle, N.W.
Washington, DC 20005
202-822-9050

Ms. Jeanne Long
CONGRESSIONAL RESEARCH SERVICE, INC.
4500 East West Highway
Bethesda, Maryland 20814